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SUBJECT: MADAGASCAR: QMM MINE BEGINS OPERATIONS

¶1. (SBU) Summary: Rio Tinto's billion dollar ilmenite mine in southern Madagascar, QMM, began production in December 2008 and shipped its first load of ilmenite in April, despite dual Malagasy political and global financial crises. The company has made a conscientious effort to hire local workers, limit its negative environmental impact, and create positive ties with local communities through development programs. Although local opinion of the company is fairly positive as a result, QMM is not immune from politicization in the current atmosphere. Those that have benefited from the opportunities offered by the mine tend to have a favorable view of former President Ravalomanana, who is credited for promoting the investment (which actually was launched under Ratsiraka). Meanwhile, transition authority president Rajoelina has vowed to review mining contracts with an eye to raising government revenue, and military forces recently raided the company to look for "mercenaries and arms." End summary.

¶2. (SBU) The sleepy, coastal town of Fort Dauphin on the southern tip of Madagascar is undergoing a transformation brought about by a USD 1 billion mining investment of the Australian/British corporation Rio Tinto. As migrants are drawn by economic opportunity, the town's population has mushroomed, and while the majority remain desperately poor, there is a buzz of hope and energy in the air that differentiates Fort Dauphin from most other Malagasy cities. The QMM project, founded in 1986, got off to a slow start but completed construction and began producing ilmenite in December 2008 and shipped its first load of mineral ore directly to Canada for processing in April 2009. Emboff visited the project March 10 and witnessed the mining of the first shipment of ilmenite, a mineral used to make paint white. QMM will export 750,000 tons of ilmenite and 25,000 tons of zirconium per year in two shipments per week to Canada. QMM officials explained that the mine has already entered into sales contracts with locked in prices for its product for the next five years, so is unaffected by mineral prices declining due to the global financial crisis.

¶3. (SBU) Rio Tinto has made a conscientious effort to hire local workers, reimburse farmers for their land, limit its negative environmental impact, and create positive ties with local communities through development programs. Along with the mine has come the construction of roads, greater electricity generation (city supply will triple), improved city water supply resulting from the construction of a dam to eliminate salt from the inland waterway, a 400 hectare industrial zone developed in conjunction with the World Bank and the GOM, and a modern port, scheduled to open for public use in July 2009. The public port will not only serve QMM, who will manage it and use it nine days per month, but will provide a modern SPS code-compliant facility that other exporters may use, as well, to export local products such as litchi and lobster. Whereas exporters from the main existing port of Tamatave in the East must ship goods through another code-compliant port such as Durban before shipping them to the United States, goods from the Fort Dauphin port will be able to ship directly to the U.S. Local Chamber of Commerce representatives are banking on this feature of the port attracting

export processing businesses to Fort Dauphin in the future.

14. (SBU) Rio Tinto is also working to improve Malagasy governance and ensure that the government's use of mining returns is transparent. QMM has agreed to participate in the Extractive Industries Transparency Initiative (EITI), and has already had a full EITI audit and will ensure full compliance, according to Director David Stone. As a member of the EITI committee, the company is also working with other mining companies, including Sherritt, to ensure that they comply by the end of 2009. QMM has agreed to a March annual EITI audit, as well as a provisional audit every September. QMM has reviewed and agreed on the tender document for a National EITI Auditor to be appointed.

15. (SBU) Along with these benefits also come some negative aspects. The mining apparatus, which resembles a moving five-story parking garage, is slowly cutting a long swath through the coastal forest. Although QMM has created nurseries, seed banks, launched experimental reforestation programs, created 625 hectares of protected areas, saved a few species of trees from extinction, and will reforest the areas in the wake of the machine's path, the mine's advance will no doubt impact the complex ecosystem of endemic plants and animals as it clears the forest. Although much of the native forest near the city has already been cut down by villagers to make charcoal, the mine will advance into fairly virgin territory through the 30 to 40 year lifespan of the project.

16. (SBU) Besides environmental concerns, the mine has also generated economic and political worries. Particularly during the construction phase, when several thousand foreign and Malagasy workers from other regions flooded the Fort Dauphin market, food and housing prices spiked, causing hardships for locals who could no longer afford basic commodities. Now that the mine has entered the production stage, it has trimmed down to only 600 employees (60% local, 30% Malagasy from other regions, 10% expat), leaving excess labor around the city to be absorbed.

17. (SBU) The mine has generated resentment and jealousies among those that are not partaking in its bounty. The acting mayor (an appointed presidential delegate) complained to Emboff that QMM did not pay taxes or royalties to Fort Dauphin, even though the city felt the impact of the project. The taxes and royalties go to other communes where the mine is physically located, as well as the regional and central governments. He argued that the QMM contract was not available to him or the public, thus he was unfamiliar with the specific terms. According to QMM Director David Stone, the company's contract is public and was passed by parliament in 1998. The company will begin paying royalties of 2 percent per shipment value in May 2009. Of the 2 percent, 70 percent will go to the region and communes, while 30 percent will go to the central government. 2009 revenue is estimated to reach USD 40 million, rising to USD 200 million by 2012. The company is exempt from corporate taxes for five years, will pay 10 percent per year from year six, and 15 percent after year ten.

18. (SBU) The regional governor and the mayor of the commune where the mine is centered were complimentary regarding the mine, the opportunities and revenue that it is bringing to the area, and the Ravalomanana administration that helped it come about. The mayor explained that her commune had implemented a participatory budget so the population could decide on what to spend the contributions that it had begun receiving from QMM last year. Last year, they used the money to build 3 schools and they will build dams this year. They lauded Ravalomanana's efforts to bring QMM, schools, and roads to the region - a region that was forgotten by prior administrations.

19. (SBU) Opposition leaders (tenuously allied with transition authority president Rajoelina and now thus in the mainstream) were more critical, complaining that QMM did not hire locals for high level positions, and alleged that the good QMM jobs and other construction contracts went to people and companies from Antananarivo. They also criticized Ravalomanana for mixing his personal and presidential assets by commandeering the land from a local gendarme base to build a Magro store, the wholesale arm of his private company. The former president had further roused their ire by cancelling mayoral elections and appointing his own delegate to avoid a win by the opposition and maintain a close hold on large

construction projects.

¶10. (SBU) Although Fort Dauphin has been quiet (too quiet, as all of the tourists have departed) during the political crisis in Madagascar which affected most major cities, QMM has not been immune from worry. After former Antananarivo Mayor Andry Rajoelina seized power on March 17, he announced that mining contracts would be reviewed with an eye towards increasing state revenue. On April 1, QMM was searched by police and military forces for arms and mercenaries, but nothing was found and no further action has been taken against the company to date. A senior QMM official who called on the ambassador later that week said he doubted that this action was driven from the top. He suspected, on the contrary, that local officials were taking initiatives that they perceived would curry favor with the new HAT regime. The search, he said, was conducted with the "utmost courtesy," and no one at the site ever felt threatened. In any case, he said QMM would take such bumps in the road in stride, and was not rethinking their investment in any way.

¶11. (SBU) Comment: Mines, like QMM and the USD 4 billion Ambatovy project, that plan to operate over several decades are taking a long-term view and continuing operations and construction despite the current political crisis. Although mining companies like Rio Tinto that have already made significant investments are moving forward with their projects, the dual international financial and Malagasy political crises have deterred new investors from entering the market. The recently publicized anti-foreign investor rhetoric of transition leader Andry Rajoelina, albeit aimed at projects associated with former President Ravalomanana perhaps more than investment in general, will further tarnish Madagascar's international image. End comment.

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